

non-representative data is not appropriate, and the Commission should reject the ETI study on these grounds.

d. ICA's Unsupported Proposal

ICA also urges the Commission to increase the productivity offset to at least 5.5 % "or higher if the record warrants it,"⁹⁵ although ICA presents no support for this proposed number. This unjustified request should be rejected.

6. The Christensen Study Presents The Only Credible Evidence Of LEC Post-Divestiture Productivity Growth And Results In A Lower Productivity Offset.

The Christensen Study,⁹⁶ filed by USTA on behalf of the price cap LECs, is the only study presented which analyzes LEC total output growth relative to total input growth to estimate LEC productivity growth. It is based on a Tornqvist index approach to measure total factor productivity, measuring the rate of change of TFP as the rate of change of the ratio of aggregate output to aggregate input. Study results indicate that the price cap LECs experienced average annual productivity growth of 2.6% over the 1984-1992 time period, which represents a productivity offset of only 1.7%.⁹⁷ This study presents credible evidence that the current productivity offset is an overly ambitious target and should be reduced. The generally accepted approach to productivity measurement does not support a higher productivity offset. This fact

⁹⁵ ICA, p. 12.

⁹⁶ USTA, Attachment 6, Laurits R. Christensen, Philip E. Schoech, and Mark E. Meitzen (Christensen Study).

⁹⁷ U.S. productivity growth of 0.9% is subtracted from LEC productivity growth of 2.6% to yield a differential of 1.7%. Christensen Study, p. ii.

shows why no party has introduced any credible evidence that the LEC productivity offset should be increased.

The Christensen Study is based on a proven and accepted approach to estimating telecommunications productivity, employing a methodology initially developed by Christensen Associates in a 1981 study of the Bell System, and subsequently used and accepted by the public utility commissions in North Dakota, Georgia, Illinois, Ohio, and Indiana.⁹⁸ The TFP approach used in the Christensen Study represents the prevailing standard for productivity measurement. For example, the Bureau of Labor Statistics uses the Tornqvist index in their industry, national and international multifactor productivity studies. Furthermore, as NERA shows mathematically, TFP is the appropriate foundation for a productivity offset. NERA states that "given the structure of the annual price cap adjustment formula, only total factor productivity can be used to set the productivity offset."⁹⁹

Significantly, several non-LEC parties also suggest that the Commission base a revised productivity offset on the standard TFP index methodology. For example, Ad Hoc states: "normally, the productivity concept is based on total factor productivity (TFP) which incorporates changes in all inputs (capital, labor and materials) simultaneously"¹⁰⁰ and considers the TFP index methodology to be "the prevailing economic approach to measurement of Total Factor Productivity which has been developed by a wide variety of economists."¹⁰¹ ICA also urges the Commission to give "substantially more weight to more recent data and to

⁹⁸ Id., p. ii.

⁹⁹ USTA Comments, Attachment 5, NERA, p. 18.

¹⁰⁰ Ad Hoc, p. 21, fn. 19.

¹⁰¹ ETI Paper, p. 65.

actual calculations of Total Factor Productivity that replicate the methods used by the US Government to calculate Multi-Factor Productivity"¹⁰² in developing the new offset. Thus, Ad Hoc and ICA both support the TFP approach used in the Christensen Study. The Christensen Study merely applied LEC historical data to this generally accepted TFP methodology to estimate LEC post-divestiture productivity. The Commission should rely on this sound study as the appropriate evidence in assessing LEC productivity achievements.

7. There Is No Evidence That Productivity Growth Has Been Increasing.

Several parties argue that technology advances have resulted in increased productivity growth and present opportunities for further productivity acceleration in the future.

For example, Ad Hoc claims:

in telecommunications, advances such as digital switching, fiber optic transport, and advanced signalling technologies, have provided LECs with enormous opportunities for productivity enhancements . . . the technology-driven productivity enhancement trend in telecommunications should continue.¹⁰³

Ad Hoc provides no data to support its claims of increased rates of change in productivity, past or future. However, an analysis of empirical data conducted by NERA revealed no trend in TFP growth or upsurge in productivity growth in recent periods.¹⁰⁴ Ad Hoc's claim is

¹⁰² ICA, p. 13. ICA further states: "the methodology used by the FCC in CC No. Docket 87-313, which developed an X-factor based upon differentials between interstate access prices and the GNP-PI inflation index may have represented the appropriate approach given the data then at hand, but it was not based upon an previously-established economic methodology or study. Better data and methods are now available, from both the LECs actual performance under the price cap plan and from actual total factor productivity data. These data should be used in lieu of the overly cautious methods used previously." ICA, p. 12.

¹⁰³ Ad Hoc, p. 20.

¹⁰⁴ NERA Reply, pp. 16-19.

unfounded and not supported by actual historical data.¹⁰⁵ While it is true that average telecommunications productivity growth historically exceeds that experienced by many other industries, this is not a new or recent phenomenon. Over the years, telecommunications experienced a host of dramatic technological advances. Certainly the advent of direct-dial service, electronic switching, one-plus dialing, touch tone and numerous other advances all had revolutionary impacts on telecommunications. The productivity gains associated with the litany of past technology advances are embedded in the historical industry TFP growth that serves as the basis for the price cap productivity offset. There is no evidence to suggest that productivity gains from the most recent wave of technological advances will surpass those of the previous "technology revolutions."

Equally important is the fact that rapid technology innovations are actually incorporated into the network gradually over time, as a series of evolutionary improvements. Decisions on technology diffusion are guided by marginal decisions, where it just makes economic sense to implement the new technology. Thus, while the underlying change in technology may be substantial, it is implemented in small increments over many years. TFP captures these changes over time, as they occur throughout markets based on economic realities. Again, there is no evidence to suggest that the diffusion process has accelerated in recent years, nor that it will in the future. The Commission should reject Ad Hoc's unsupported contentions that recent or future technology advances justify a higher productivity offset.

¹⁰⁵ This is discussed more fully in SWBT Appendix PROD, pp.18-19.

8. Productivity Gains Cannot Be Inferred From Annual Earnings Results.

Many of the commenters claim that there is a strong, direct correlation between annual productivity and earnings results.¹⁰⁶ For example, AT&T, MCI, and GSA all propose a higher productivity offset that would have resulted in LEC earnings being fixed at an arbitrary ROR limit had it been in effect during the price cap review period. These proposals imply that productivity gains directly translate into higher achieved earnings. However, this premise is simplistic and seriously flawed.

The LECs' reported earnings are based on regulatory accounting rules and thus, do not reflect true economic earnings. Other factors beyond productivity also affect the LECs' achieved accounting earnings. It is the combined effect of the impacts of all these factors that determines achieved earnings growth. Certainly, higher productivity positively impacts one component of achieved accounting earnings, but other factors resulting from regulatory accounting rules also impact accounting earnings. These factors could affect earnings in the opposite direction from productivity effects, so that realized earnings could rise or fall while productivity growth could be unchanged. As SWBT has stated, although measures of productivity relate to operating results, they do not use accounting data directly.¹⁰⁷ Productivity measures do not match accounting rules, but measure physical gains or losses. LEC reported earnings, on the other hand, reflect both physical and monetary (price, accounting and other financial) factors. As a result, achieved earnings cannot be used as a surrogate for productivity growth as the LECs' competitors suggest. A more detailed explanation of why

¹⁰⁶ NPRM, para. 44.

¹⁰⁷ SWBT, p. 42.

productivity gains are not synonymous with an increase in earnings is contained in Appendix ACCTEARN, attached hereto.

F. Changes To The Common Line Formula Should Be Made. (Baseline Issues 5a, 5b, 5c, 5d)

1. The Balanced 50-50 Formula Should Be Revised.

As SWBT stated, a transitional plan should be developed which permits LECs the flexibility to shift the non-traffic sensitive loop costs that the CCL rate currently recovers to the appropriate cost causer (the end user) through increases of the EUCL charge.¹⁰⁸ A flat-rated CCL mechanism could be used as an interim measure, until the non-traffic sensitive (NTS) costs are recovered from end users.¹⁰⁹ The need to reform non-traffic sensitive cost recovery has also been recognized by the LECs' competitors and customers. For example, AT&T states:

As AT&T has repeatedly urged, end user charges that fully reflect costs are the most economically rational and cost causative method for non-traffic sensitive cost recovery.¹¹⁰

In order to facilitate an orderly transition of the price management of common line rate elements, SWBT recommends a single two-part change to the Common Line price cap index treatment.¹¹¹ SWBT's proposal corresponds to the Commission's originally stated objective of allowing the LECs to benefit from demand growth.

¹⁰⁸ SWBT, p. 48.

¹⁰⁹ Id.

¹¹⁰ AT&T, p. 27, note 34.

¹¹¹ Id., pp. 49-50. This proposal is described in Appendix CL PCL.

The LEC Price Cap Order articulates and embraces the proper rationale for the LECs' retention of revenue from carrier common line (CCL) demand growth. The Commission stated:

The fundamental principle of price cap regulation is that increased efficiency is most surely generated by profit incentives' where the LECs have the ability to spur higher productivity, they should be given a fair incentive to do so. . . . [W]e continue to believe that the LECs have opportunities to affect this particular form of productivity gain. The LECs directly provide some services that generate interstate CCL minutes of use, such as foreign exchange and interexchange long distance...Moreover, installation of new technologies such as SS7 signaling can increase the vitality of competition in areas such as 800 service, helping generate lower rates and increased demand. Improvements in network facilities and operations should also encourage usage over common lines...[e]xpanding features available with toll services, such as call waiting and call forwarding, and developing entirely new common line-based services such as ISDN, would increase the value of common lines to customers, and thus the usage per line. LEC advertising to encourage calling and to highlight the benefits of telephone service generally is likely to spur interstate as well as local and intrastate toll traffic. The LECs frequently provide the billing and collection services associated with services using the CCL rate elements, and their improvements in the utility of the information contained in the bills, the reduction of uncollectibles, and the lowering of the price can all be expected to stimulate CCL-based service. . . . ¹¹²

In essence, the Commission correctly concluded that LECs influence CCL demand growth. It remains in the LECs' best interest to stimulate usage on the public switched network because stimulated usage tends to produce revenues for LECs. When that usage results in an interexchange call, the LEC may receive access charges. Thus, the IXCs and LECs share a common goal concerning CCL usage: demand growth yields increased revenues for both parties.

¹¹² LEC Price Cap Order, para. 65.

The Commission selected a mechanism -- the Balanced 50-50 Formula -- that recognizes and encourages LECs to invest in their networks in pursuit of the goal of stimulating demand. The Commission concluded:

[t]here is no determinative evidence in the record to establish whether future productivity from demand increases will originate more from LEC or interexchange carrier efforts. However, we conclude that future growth can be maximized only if both are encouraged to search out ways to become more productive, and both are rewarded for their success.¹¹³

The IXCs' "per line" formula recommendation would violate this fundamental premise.

Contradicting the Commission's reasoning in adopting the Balanced 50-50 Formula, AT&T and MCI imply in their comments that the implementation of the LEC price caps plan, and in particular, the Balanced 50-50 Formula is somehow responsible for the slowing of CCL usage growth.¹¹⁴ In reality, price caps has nothing to do with this downward trend in CCL usage.

In a recent study, the National Exchange Carrier Association (NECA) traced the principal reasons for the decline in CCL demand growth.¹¹⁵ These reasons include: competitive and bypass alternatives were actively pursued by the IXCs, thus taking switched access traffic off the LECs' networks; and the trend of interstate switched access price reductions continued, but tapered off in 1991-93, compared with the 1986-89 time period, primarily due to the 1989 completion of the phase-in of the End User Common Line (EUCL)

¹¹³ Id., para. 69.

¹¹⁴ AT&T, pp. 26-27; MCI, p. 22, fns. 36, 37.

¹¹⁵ Victor Glass, NECA, "A Competitive Analysis of the U.S. Telecom Industry," December 1993, pp. 12-14.

charge. Also, the interstate access price reductions from 1991-1993 were not passed on to end users in the form of lower long distance prices. AT&T, while complying with applicable price cap rules, kept some of the access price reductions, without reflecting these in lower residence interstate long distance prices. These reasons taken together explain why MCI is completely wrong in its statement that "the LECs were incapable of stimulating demand to the level anticipated in the Commission's Balanced 50-50 formula".¹¹⁶ Pursuing the IXCs' own line of argument, lower CCL demand growth in the past three years would also likely indict the IXCs, since, assuming arguendo, IXCs affected the demand for CCL minutes, the IXCs apparently failed in their own efforts to stimulate demand.

In fact, a primary determinant of the demand for access is its price. The significant reductions in LEC access charges over the 1991-93 time period¹¹⁷ were an important stimulating factor to CCL demand. The price cap LECs reduced switched access charges by a cumulative \$3 billion during 1991-93.

Table 4
Cumulative Value of Price Declines
Price Cap LECs

| | 1991-93 |
|----------------------------|----------|
| Common Line | (\$1.3B) |
| Switched Traffic Sensitive | (\$1.7B) |
| Total Traffic Sensitive | (\$3.0B) |

¹¹⁶ MCI, p. 37.

¹¹⁷ These per-minute prices would have fallen even more rapidly if EUCL rates had risen over this period as they did over the 1986-89 time period.

This factor alone has had a significant positive effect on CCL demand.¹¹⁸ Also, and very importantly, the continuing network improvements correctly described by the LEC Price Cap Order punctuate the strong role that the LECs have in stimulating demand.

Clearly, the Commission and other parties recognize that imposing the per-line formula in the price cap plan would require significant offsetting adjustments. However, SWBT and others have demonstrated that LECs should retain the benefits of CCL demand growth. The Commission should reject the IXCs' self-serving arguments for a per-line CCL formula.

2. The Commission's Quantification Of A Common Line "Trade-off" Of 0.5 Percentage Points Is Understated.

MCI apparently accepts the Commission's quantification of the effect that the per-line common line treatment has on the productivity offset, recommending a reduction of 0.5 percentage points if the per-line treatment is used.¹¹⁹ AT&T, on the other hand, performs its own calculation concluding the productivity offset must be reduced by 0.8 percentage points if the per-line common line treatment is forced on the LECs.¹²⁰ At the time that the Commission examined this issue in 1989-1990, the Commission concluded that the effect was 0.7 percentage points.¹²¹ SWBT's recent analysis indicates that a reduction of 1.1 percentage points in the productivity offset is necessary if the per-line common line price cap treatment is imposed. The

¹¹⁸ LEC Price Cap Order, para. 68.

¹¹⁹ MCI, p. 23. The simple observation that few of the LECs' customers or competitors proposed alternative quantifications is sufficient to indicate that they have already confirmed that the Commission's 0.5 percentage point quantification is significantly understated.

¹²⁰ AT&T, Appendix B, p. B-5.

¹²¹ LEC Price Cap Order, fn. 107. ("We estimate that the 2.8 percent baseline productivity offset using the Balanced 50-50 formula is equivalent to a 3.5 percent offset under the originally proposed formula at 8 percent demand growth." Estimated the difference between 50-50 and per-minute.)

per-line formula is totally inconsistent with incentive regulation, where demand growth is an important source of productivity.¹²²

IV. **PRICING RULES MUST MATCH THE COMPETITIVENESS OF LEC MARKETS.**
(Transition Issues 1b, 1c)

In Transition Issue 1, the Commission requested comment on what constitutes the "most relevant and useful criteria for determining when to adopt streamlined regulation," and proposes a number of specific factors for such a determination.¹²³ Not surprisingly, those who would benefit from keeping the LECs under tight regulatory control generally argue that competition is virtually nonexistent and will remain so for years to come. Some even assert that it is premature for the Commission to address these issues at this time.¹²⁴ One party proposes a radically different and inappropriate paradigm for determining the competitiveness of markets.¹²⁵

As SWBT has shown in its Comments and again here, SWBT is already today facing substantial competition for interstate access services in a number of markets. Sound competitive standards are an extremely important component of regulatory policies that will shape the transition from today's asymmetric regulation to the proper classification and

¹²² Christensen shows that economies of density (as revealed by demand growth) is a primary source of productivity growth. Christensen Study, p. 13.

¹²³ NPRM, para. 95.

¹²⁴ For example, see Sprint, pp. iii, 25; AT&T, pp. ii, 18; ALTS, pp. 16-19.

¹²⁵ SWBT explains in Appendix TRANSCOST why the transaction cost economic paradigm proposed by ALTS is wholly inappropriate.

regulation of services and markets. SWBT's position on the proper economic and policy framework for competitive market determination is detailed in Appendix MKT.¹²⁶

SWBT urges the Commission to promptly adopt regulations that adapt to competition as conditions warrant, and to subsequently proceed with an appropriate assessment of competition for interstate access services. The effect would be more streamlined regulation in those markets where LECs can demonstrate that they no longer possess market power.

In Transition Issue 1c, the Commission addresses the related issue of "bottleneck" control and requested comment on the circumstances under which a LEC no longer controls essential "bottleneck" facilities for some or all of its services.¹²⁷ It appears that some parties equate "bottleneck" control with market power¹²⁸ or rely on an overly broad definition of "essential bottleneck facility" in urging the Commission to maintain stringent regulatory control over LEC services.¹²⁹

The status of telecommunications technology and the pace of competitive entry demonstrates the lack of a "bottleneck."¹³⁰ The availability of competitive access supply would

¹²⁶ Appendix MKT also addresses flaws in parties' comments regarding the assessment of market power.

¹²⁷ NPRM, para. 95.

¹²⁸ For example, see MCI, p. 76 ("regulation must be imposed on local service providers commensurate with their demonstrated level of bottleneck control or market power").

¹²⁹ MFS, for example, explicitly defines "bottleneck" in such an overly broad manner: "the LEC 'bottlenecks' take a variety of forms. MFS uses this term to refer to any means by which a LEC can impede competitors . . . from providing all forms of telecommunications services to all customers . . ." MFS, p. 40.

¹³⁰ SWBT, pp. 11-12 (LECs no longer control "bottleneck" facilities) and Appendix COMP; Section II.B.1. supra. (extensive competitive supply already exists).

not exist to the extent that it does today if the "bottlenecks" implied by the LECs' competitors were present.

While SWBT detailed elements of a proper "essential facilities" definition in its Comments, a better approach for the Commission would be to avoid the use of such labels. The fact that access to a facility is desired by a competitor does not by itself render a facility essential. As one antitrust author has stated:

[t]he 'essential facility' is just an epithet describing the monopolist's situation: he possesses something that the plaintiff wants. It is not an independent tool of analysis but only a label—a label that beguiles some commentators and courts into pronouncing a duty to deal.¹³¹

The essential facilities doctrine has not worked well in the antitrust courts and has been vigorously criticized. Just as this doctrine has been a very dangerous one in the courts,¹³² it would be equally dangerous, or even more so, in regulatory fora as interested

¹³¹ Phillip Areeda & Herbert Hovenkamp, *Antitrust Law* 859 (Supp. 1993), ¶¶ 736.1-736.2. For useful recent discussions of the legal content of antitrust's essential facility doctrine, see William B. Tye, "Competitive Access: A Comparative Industry Approach to the Essential Facility Doctrine," 8 *Energy L.J.* 337, 346 (1987); James R. Ratner, "Should There Be an Essential Facility Doctrine?," 21 *U.C. Davis L. Rev.* 327, 367 (1988); Phillip Areeda, "Essential Facilities: An Epithet in Need of Limiting Principles," 58 *Antitrust L.J.* 841 (1990)(Areeda, Essential Facilities); William Blumenthal, "Three Vexing Issues Under the Essential Facilities Doctrine," 58 *Antitrust L.J.* 855, 857-58 (1990).

¹³² See, Panel Discussion, Exclusionary Conduct, 57 *Antitrust L.J.* 723, 742 (1989) (remarks of William Baxter: "Someone invested in the essential facility. Someone got out in front when it wasn't at all clear that the facility was going to work, and now someone else wants to come along and help themselves. The doctrine is a very dangerous one.")

parties try to stretch the doctrine beyond its intended purpose, and use labels rather than reason in their positions.¹³³

A. Unnecessarily Restrictive Regulation Impedes Competition.

As the Commission recognized in the NPRM, the price cap plan:

does impose significant regulatory constraints upon carriers. Such constraints may become unnecessary or counterproductive when market forces generated by competition effectively assure reasonable, and not unreasonably discriminatory rates. Rate regulation in these circumstances may impede the incumbent carrier's ability to compete vigorously rather than protecting customers or achieving the other goals of the Communications Act.¹³⁴

Continuation of the current price cap regulation, with the many constraints it imposes on the LECs, provides the wrong market signals to current and potential competitors and may well induce entry by less efficient providers. The result is a market that does not make efficient use of scarce resources: (1) high-cost providers may flourish, resulting in technical

¹³³ For example, Areeda cites the following cases in which the essential facilities doctrine was used to foster the business objectives of plaintiffs, but not necessarily in the original spirit or intent of the doctrine: "... a rock impresario seeking admission to the local auditorium; a teletype machine marketer complaining that its competitor will not sell machines for it; a ski resort complaining that a rival resort will not engage in joint marketing with it; a maker of 'muscle building' food supplements demanding that a body building magazine accept its ads; a paper retailer complaining that other paper retailers will not admit it to their wholesale buying co-op; an anesthesiologist insisting that the local hospital, using in-house anesthesiologists, allow him to perform anesthesiological services as well; or the would-be oil seller, who has no storage tanks of his own, demanding to use those of an incumbent seller — to say nothing of Berkey, who wants to know the results of Kodak's research before Kodak markets its own innovations." Areeda, Essential Facilities, pp. 843-44. Poorly defined "essential facilities" for public policy purposes could allow firms seeking access to LEC network functions to employ essentially the same logic as exhibited in the cases Areeda cites, to no improvement in the public interest.

¹³⁴ NPRM, para. 92.

inefficiencies; and (2) the prices of goods and services may not reflect the true value of the resources used to produce them, resulting in allocative inefficiencies.¹³⁵ The economic costs that result from such inefficiencies ultimately are imposed on customers and society as a whole. Therefore, it is critically important that the Commission revise its regulation to allow all providers, including the incumbent LECs, to fairly compete in all markets where competition exists. To foster effective competition, LECs must be able to adjust prices and services right from the start, and not only after competitive providers have become established as a result of improper pricing and marketing signals by the regulatorily restricted LEC.

Central to reduced regulatory oversight of any market are two economic maxims. The first and most basic of these is that explicit price regulation should only be applied to services for which there is "market power." Market power is defined as the ability of a firm (or group of firms) to increase prices above competitive levels for a significant period of time. Regulation is required as a ceiling on the upper limits of prices for services that are "vested in the public interest" and for which the seller has market power. However, if all firms in the market for a given service lack the ability to exercise market power, the market is workably competitive and should be subjected only to minimal regulatory oversight.

The second economic maxim is that regulation should be applied to markets, not "large" firms or "large" market participants. Market power can only be determined within the context of the entire market, its economic structure, and its participants. Thus, proper definition

¹³⁵ Technical efficiency refers to the efficient combination of inputs to produce output at the least opportunity cost; allocative efficiency refers to prices which reflect true costs of production. See, The MIT Dictionary of Modern Economics (David Pearce ed. 3rd ed. 1986), pp. 13-14.

of the market is critical. Defining the relevant market has a product dimension (it includes all substitutable products and services) and a geographic dimension (the area within which customers have sufficient alternatives so they can substitute away from the LEC's services should the LEC raise prices). The fundamental issue thus becomes selection of the indicators that policymakers can use to determine when competition exists in a market in order to relax explicit regulatory scrutiny of prices, i.e., when is a market becoming workably competitive?¹³⁶

B. Local Exchange Competition Does Not Have To Exist To Have Vigorous Access Competition.

Several years ago, MFS argued that special access interconnection was required before effective competition for access services could be achieved. After special access expanded interconnection was established by the Commission, MFS argued that switched access expanded interconnection was required before truly effective competition could take place. Now, MFS claims that price regulation of access services through market forces cannot occur until competition encompasses all LEC services including basic local exchange.¹³⁷ Similarly, Teleport believes that "the relevant market for assessing the degree of competition should be the total regulated market currently served by LECs, which would include access services, local services, intraLATA toll, and associated (tied) services (such as directory assistance, directory publishing)."¹³⁸ Both MFS' and Teleport's positions should be rejected.

¹³⁶ The proper economic framework for the assessment is described in Appendix MKT, attached hereto.

¹³⁷ MFS, p. 4.

¹³⁸ Teleport, pp. 22-23.

In contrast to the comments of MFS and Teleport, it is widely recognized that there are two basic attributes that define a market: product dimension, and geography.¹³⁹ With regard to the product dimension, the "market" for a particular service includes all substitutable products and services. A DS3 circuit, for example, is a viable substitute for multiple DS1 services and special access services are viable substitutes for switched access and visa versa. No customer, however, can substitute local exchange services for access services and the presence or absence of alternate local exchange providers has no influence on access purchasing decisions. Similarly, Teleport's assertion that directory publishing should also be considered in the relevant access market is ludicrous. The fact that a LEC publishes Yellow Pages, for example, does not influence customers' access purchasing decisions.

The other criterion for a market definition is geographic dimension, a fact acknowledged by several competitors.¹⁴⁰ The appropriate geographic size of the market should be defined as that area within which customers have sufficient alternate service choices to preclude exercise of market power. LEC serving areas, state boundaries and "zones" in general represent too large an area to be considered a market for LEC access services. The Commission should conclude that the geographic nature of competition should be reflected in the price cap plan. The proper starting point to determining a geographic market is to obtain alternate

¹³⁹ These attributes are further explained in Appendix MKT, attached hereto.

¹⁴⁰ For example, *see* MFS, p. 44 ["the Commission should examine whether a LEC is subject to competition for all services in a given geographic market"]; TCG, p. 27 ["it is certainly true that the degree of competition varies from place to place"]; ICA, p. 11 ["to evaluate the degree of competition relative to the overall size and traffic levels in the particular exchange or market area"]; MCI, p. 70 ["the Commission must recognize that the LEC monopolies are geographically based and that a significant degree of competition in one area has no effect whatsoever on the customers' choices in other LEC serving territories"].

provider facility maps or serving areas. From there, customer demand is mapped into this data to determine relevant markets having alternate supply. It is erroneous to "lump in" LEC demand from areas where no alternative exists with demand from highly competitive areas to "dilute" the CAP presence in these highly competitive areas. MFS and Teleport are attempting to do just that by proposing that regulators must look at entire LEC serving areas, and by including nonsubstitutable services as part of the relevant market.

Any legitimate attempt to measure market competitiveness must analyze both substitutable services and geography. MFS' and Teleport's proposals do neither. To foster competition, regulation of access markets must reflect economic markets so that proper regulation can be applied to markets with different degrees of competition, i.e., streamlined regulation in competitive markets and price cap regulation in economic markets exhibiting less competition.

C. The Presence Of Common Plant Does Not Provide An Opportunity To Shift Revenues From Local Exchange To Access Services.

MFS wrongly claims that:

given the pervasive use of common facilities within LEC networks, the only meaningful way to analyze 'the current state of competition' is with respect to all services offered in a geographic area large enough to encompass the major part of shared and common facilities.¹⁴¹

All businesses have common costs that must be shared between services. Many of SWBT's interoffice facilities are provided over common fiber optics. However, this does not mean that SWBT "can simply shift recovery of shared and common costs to other services or geographic

¹⁴¹ MFS, pp. 38-39.

niches"¹⁴² as MFS alleges. The Commission's jurisdictional cost separations rules define the separation of costs between interstate and intrastate. Both the Commission and the state public service commissions closely review compliance with the separations rules. As a practical matter, moreover, the record does not support a movement of cost to state jurisdictions resulting in price increases. For example, in Missouri and Texas, local exchange rates have not increased in over 10 years.

In addition, the USTA proposal calls for price cap regulation applied to less competitive market areas and streamlined regulation applied in markets only after a demonstration that competition is present. In this paradigm, the carrier has no ability to increase the prices for services in less competitive markets when the prices are reduced for services in streamline-regulated competitive markets.

The record simply does not support MFS' theory. In addition to the LECs, many of the LECs' competitors have integrated networks. IXC's can integrate access with facilities currently used for interexchange traffic. Cable Television firms can integrate access with fiber currently used for backbone facilities used to provide CATV service. As CAPs interconnect with LECs, IXC's, CATV and others, their networks are integrated. Electric utilities can integrate access with their fiber networks currently used for system monitoring purposes. All of these providers have integrated networks and thus the fact that LECs have integrated networks does not preclude competition.

¹⁴² MFS, p. 39.

D. New Services Rules Must Provide Increased Consumer Benefits And Provide LEC Competitiveness. (Baseline Issues 8a, 8b, 8c)

Some of the LECs' competitors recommend that the only changes to the new services rules under price caps should be to increase the regulatory oversight of new services. For example, MFS states that the Commission's definition of new services is entirely too broad and that LECs underprice new services in a discriminatory fashion in order to target selected customers in selected markets.¹⁴³ Thus, MFS would have the LECs be required to set higher prices for new services -- a result that maintains a comfortable pricing umbrella for the LECs' competitors.

MFS offers no support for its recommendations. In response to problems that do not exist, MFS proposes a four-step remedy. MFS suggests that: (1) new services should be incorporated into price caps immediately utilizing projected demand; (2) services should be classified, for the purposes of price management, based on their underlying functions and facilities; (3) new services in the trunking basket should be subject to a cost consistency test; and (4) the Commission should continue to preview new services tariffs prior to their effectiveness.

Another LEC competitor states that there is "no need for changes in the current treatment of new services under price caps."¹⁴⁴ Teleport asserts that the current Commission requirements for the introduction of new services do not impose any undue burden upon the affected service providers.¹⁴⁵ While some parties express concerns that LECs will price their

¹⁴³ MFS, p. 26.

¹⁴⁴ Teleport, p. 12.

¹⁴⁵ MFS, pp. 21-25; Teleport, p. 11; Sprint, p. 21.

services below costs,¹⁴⁶ others are concerned that LECs would "price gouge their customers."¹⁴⁷

The only consistency between these commenting parties is in their primary motive for opposing any relaxation in the new services regulation: protect the regulatory advantage that they currently enjoy, without regard to consumer welfare or the observed facts. If public benefits are to be maximized, the Commission must move to a pure price cap plan in those markets where regulation continues to be warranted and to disengage price regulation in those markets where the effects of competition will adequately safeguard the market.

Competitors must recognize that new services increase the range of alternatives available to consumers while maintaining all the service options available to consumers before the new service was offered.¹⁴⁸ The Commission has defined new services precisely this way.¹⁴⁹ Because of the distinguishing fact that existing service options remain available to customers, they can be made no worse off as the result of the introduction of the new service.¹⁵⁰

¹⁴⁶ MFS, p. 26; PaOCA, p.12.

¹⁴⁷ Ad Hoc, p. 29.

¹⁴⁸ SWBT, p. 73.

¹⁴⁹ LEC Price Cap Order, para. 314. "We will consider as new, services which add to the range of options already available to customers. A new service may, but need not, include a new technology or functional capability. Many new services are, in essence, re-priced versions of already-existing services. It is indeed rare for a carrier to offer a wholly different form of telecommunications service. As long as the pre-existing service is still offered, and the range of alternatives available to consumers is increased, we will classify the service as new."

¹⁵⁰ SWBT, p. 74.

While the Commission has adequately defined the nature of what constitutes a new service, it has not clearly and consistently outlined the requirements for the introduction of new services, nor addressed the varying nature of the marketplace in terms of competitiveness and customer needs.

Comments filed in this and other proceedings demonstrate the inadequacy of the current access charge plan. Unfortunately, repeated attempts to remedy only the immediate symptoms does little to cure the underlying condition. For this reason, the USTA proposal for fundamental regulatory reform should be implemented.¹⁵¹

LECs have not been given a consistent set of requirements for the successful introduction of new services. New services are becoming technically available at an ever more rapid rate with the swift evolution of technology. In spite of these dramatic gains in technology and the rapid growth and already significant effects of competition, the regulatory model has not kept pace. Price cap LECs have been subjected to a varied menu of new service justification requirements.¹⁵² Clearly, the Commission has given this issue extensive treatment. What the Commission should now adopt is a new regime which captures more appropriately the ability of the market to discipline LEC pricing of new services, as expressed by SWBT in its comments in this proceeding. The Commission must not allow itself to be persuaded by parties who seek only to protect their competitive advantages. The Commission has before it a unique opportunity to remedy the deficiencies of the current access charge rules that apply to new services.

¹⁵¹ See, United States Telephone Association Interstate Access Reform Proposal, filed September 17, 1993. (USTA Petition).

¹⁵² SWBT, pp. 30-31.

There is no reason to incorporate new services immediately into price caps as suggested by MFS.¹⁵³ In fact, the Commission itself decided to hold new services outside of price cap for a period of time to encourage new service introductions.¹⁵⁴ The Commission concluded that by allowing new services to stay outside of price caps for a brief period, LECs would have further incentives to innovate. Further, this lag would give LECs the time necessary to develop the historical demand figures necessary to accurately compute the various required price cap formulas.¹⁵⁵

Moreover, there is no need for the Commission to lengthen or maintain the existing 45-day review period in competitive market areas or in market areas where competition is in transition.¹⁵⁶ Just like LECs need to be able to meet the rapidly changing needs of their customers, MFS has never suggested that public benefit reasons should prevent MFS from rapidly introducing its own new services. In fact, MFS openly acknowledges "18 months may exceed the lifespan of many service offerings in emergingly competitive markets."¹⁵⁷ The delivery of new services is already naturally delayed during the service development and negotiation process. Further unnecessary regulatory delays that serve only to provide MFS and other LEC competitors with artificial market advantages actually harm the public. Adopting

¹⁵³ MFS, pp. 26-27.

¹⁵⁴ LEC Price Cap Order, para. 319.

¹⁵⁵ Id.

¹⁵⁶ Teleport, p. 12.

¹⁵⁷ MFS, p. 29.

these MFS suggestions only prevent access customers from the benefits of low-cost new service alternatives.

Teleport claims that if a competitor can effectively respond to a proposed LEC offering in less than 45 days, it "probably indicates that the 'new' LEC service is not very new after all."¹⁵⁸ Teleport fails to address the fact that in many instances LECs and competitors have already been working for some time to develop solutions to address rapidly evolving customer needs. This development time occurs before the tariff process is initiated. The LEC, however, is the only supplier required to publicly disclose its proposed new service and to answer detailed objections by its competitors for an extended period of time before ever being allowed to provide the service.¹⁵⁹ This regulatory process is simply not logical in competitive situations. Competitive firms go to great lengths to protect the proprietary nature of their product and service development. This reality must find its way into the regulation of the LECs. The increase in competition requires that the need for proprietary treatment of sensitive business information must also increase.

Customers openly solicit new service solutions from multiple providers in order to maximize the value of their telecommunications expenditures. Success in the LEC-customer relationship is impeded by the knowledge of the prescribed regulatory delay and the threat of even longer delays. In fact, by filing oppositions to LEC filings, competitors extend the length

¹⁵⁸ Teleport, p. 12.

¹⁵⁹ There are no other examples of competitive markets in the U.S. or the world where one group of the competitors (in this case the LECs) must submit their proposed new services to a process where the other competitors (in this case the CAPs, IXC's, Cable TV companies and private network providers) can oppose the services and delay their introduction for numerous months or years.

of the regulatory review process postponing further the actual effective date of the LEC new service. Ultimately, the customer is prevented from choosing from a full range of alternatives; society is worse off and the economy suffers.

Some parties routinely raise the objection that detailed cost support for new services is essential.¹⁶⁰ On the contrary, new services offered within fully competitive market areas should be exempted from price cap regulation and therefore no cost support would be required. The competitive market is fully capable of regulating prices of both CAP and LEC services. The regulatory cost support for services in market areas subject to competition should be limited to an incremental cost showing as an additional safeguard against predatory pricing. The price cap constraints for remaining market areas prevent the LECs from recouping losses in competitive markets because of price caps in those remaining market areas.¹⁶¹ As a result, the price cap form of regulation and the grouping of markets by degree of competition eliminates any incentive or ability to engage in cross-subsidization or predatory pricing.

MFS and Teleport would be likely to consider their regulatory strategies successful if they convinced the Commission to require detailed, even excruciatingly laborious or impossible, cost support requirements on all of the services of the LECs. The Commission

¹⁶⁰ MFS, p. 27; Teleport, p. 11; Ad Hoc, p. 29; PaOCA, p. 12; ICA, p. 20; MCI, pp. 52-55.

¹⁶¹ Price reductions in competitive markets do not increase the price cap indexes for less competitive markets. For agreement, see, Policy and Rules Concerning Rates for Dominant Carriers, AT&T Comments, CC Docket No. 87-313, filed July 26, 1988. (AT&T 1988) ("Quite apart from competition, price cap regulation itself would altogether deny AT&T the opportunity to recoup predatory losses and thus remove any incentive to incur such losses.") p. 16.